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Points to Watch With Revocable Trusts

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-by Neil E. Harl*

Revocable trusts go by several names – living trusts, *inter vivos* trusts, revocable trusts, grantor trusts – but regardless of name, the trusts bearing any of the names are basically the same, although such trusts should be read with care because the language used in the trust may affect the ultimate disposition of the property held in the trust. With such a trust, the grantor creates the trust by executing a trust agreement and ordinarily funds the trust by transferring property to the trust during the life of the grantor.

General features

The grantor of a revocable living trust retains the power to amend, modify or even revoke the trust and often retains the right to the income generated by the trust. Because of the powers retained by the grantor over the trust, the property within the trust is potentially subject to the federal estate tax if the estate is large enough.[1]

Surprisingly to many, the Chief Counsel's Office has ruled that grantor trusts are disregarded as entities separate from their owners for all federal income tax purposes.[2]

With reservation of the power to revoke the trust, transfer of property to the trust does not constitute a gift.[3] However, subsequent termination of that power, other than by death, completes the gift for federal gift tax purposes.[4]

Concerns in funding a revocable living trust

Transferring the principal residence to a revocable living trust does not make the residence ineligible for an exclusion of gain under I.R.C. § 121.[5] Moreover, it does not preclude a mortgage interest deduction if the taxpayer has an "equitable and beneficial interest" in the residence.[6]

Expense method depreciation[7] does not apply to trusts and estates.[8] However, there is a question as to whether a grantor trust is a trust for this purpose. A high percentage of revocable *inter vivos* trusts are essentially disregarded for federal income tax purposes.[9]

Conveyance of joint tenancy property to a revocable living trust apparently can result in a severance of the joint tenancy characteristic, at least under some circumstances.[10]

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ENDNOTES

[1] I.R.C. §§ 2001, 2002. See also I.R.C. §§ 2036-2038. See Estate of Bell v. Comm'r, 66 T.C. 729 (1976) (broad powers held by the grantor who was also a co-trustee). See Treas. Reg. § 20.2038-1(a). See also Ltr. Rul. 200730011, April 25, 2007 (taxpayer deemed owner of trusts, spouse held power to withhold distributions). Compare Sulovich v. Comm'r, 587 F.2d 845 (6th Cir. 1978) (powers retained by grantor-trustee of savings accounts).

[2] CCA 201343021, June 17, 2013. See also Rev. Rul. 85-13, 1985-1 C.B. 184.

[3] Treas. Reg. § 25.2511-2(c).

[4] Treas. Reg. § 25.2511-2(f).

[5] Ltr. Rul. 9912026, Dec. 23, 1998 (taxpayer considered owner of residence for purposes of exclusion of gain even though title transferred to revocable *inter vivos* trust). See Ltr. Rul. 200104005, Sept. 11, 2000 (trust settlor considered owner of residence (where title in trust) to extent of 5/5 power; Ltr. Rul. 8007050, Nov. 23, 1979.

[6] Uslu v. Comm'r, T.C. Memo. 1997-551 (title to residence in brother's name because of poor credit rating following bankruptcy filing; taxpayer occupied property and paid all expenses). See Bonkowski v. Comm'r, 458 F.2 709 (7th Cir. 1972), *aff'g,* T.C. Memo. 1970-340 (no legal, equitable or beneficial interest in mortgaged residence; deduction for mortgage interest disallowed). See Ltr. Rul. 9516026, Jan. 19, 1995.

[7] I.R.C. § 179(d)(4).

[8] I.R.C. § 179(d)(4).

[9] CCA 201343021, June 17, 2013.

[10] Black v. Comm'r, 765 F.2d 862 (9th Cir. 1985) (terms of trust substantially diminished survivor's right of survivorship). But see Estate of May v. Comm'r, T.C. Memo. 1978-20 (no severance where joint tenancy property transferred to trust and subject to joint power of revocation).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

AUTOMATIC STAY. The debtor had filed a fifth Chapter 12 case, 21 years after filing the first Chapter 12 case. The main creditor was the Farm Service Agency which held a mortgage on the debtor's farm. During the fourth Chapter 12 case, the debtor's plan was confirmed and the debtor received a discharge. However, the debtor failed to make all payments to the FSA and the FSA sought to commence foreclosure proceedings. The debtor filed the fifth case to stay the foreclosure proceedings. The debtor admitted that the taxes on the farm had not been paid and that the debtor had not purchased insurance for the property. However, the value of the farm was $246,573 with outstanding claims of $65,712 for the FSA and property taxes owed of $28,627. The FSA sought relief from the automatic stay under Section 362(d)(4)(B) for "a scheme to delay, hinder, or defraud creditors that involved . . . multiple bankruptcy filings affecting such real property." The court found that the first three cases indicated a scheme to delay the collection of the FSA debt; however, the fourth case was successfully concluded, and although not all debts were paid, the FSA did receive a substantial payment under the plan. The court also found that the debtor had timely filed a plan and not made any attempts to delay or hinder the proceedings. Thus, the court held that relief from the automatic stay would not be granted under Section 362(d)(4)(B). The FSA also sought relief under Section 362(d)(1) for cause. The court stated that "a slim and eroding equity cushion is sufficient to establish cause" for relief from the stay. To determine the sufficiency of protection of secured estate property, the court considered the size of the equity cushion; the rate at which the cushion will be eroded; whether periodic payments are to be made to prevent or mitigate the erosion of the cushion; and, if the property is to be liquidated, the likelihood of a reasonably prompt sale. In this case, the court found that the debtor had substantial equity in the property but the debtor did not provide any proof of insurance to prevent catastrophic loss. Thus, the court granted the relief from the automatic stay to the FSA but noted that, if the debtor produced evidence of sufficient insurance on the property the stay would be reinstated unless the debtor took any actions to further unreasonably delay the case. ***In re* Olayer, 2017 Bankr. LEXIS 4045 (Bankr. W.D. Penn. 2017)**.

PLAN. The debtor filed for Chapter 12 and filed a proposed plan which provided for the leasing of a field sprayer to the debtor's nephew and using the lease payments to pay the loan payments on the sprayer. The plan also provided for an extension of two years on the loan and an increase in the interest rate by 1.5 percent. The value of the sprayer exceeded the balance on the loan and the court found that the loan would be oversecured for the life of the loan so long as the sprayer was properly maintained. The plan also provided that, if the nephew defaulted on the lease payments, the sprayer would be sold. Section 1222(b)(2) allows a Chapter 12 plan to modify a secured claim by extending the payment period, if the plan provides that the creditor will retain its lien over the property. The creditor argued, however, that the plan was not feasible under the evidence because the debtor did not provide any evidence that the nephew had sufficient income to make the lease payments. The court found that the debtor also failed to show that the debtor could make the payments if the nephew defaulted. The court held that the debtor failed to demonstrate that the plan was feasible and denied confirmation of the plan. ***In re* Furman. 2017 Bankr. LEXIS 4306 (Bankr. D. Kan. 2017)**.